COLLAS CRILL

Here to stay: The burgeoning crypto market and its crossover with insolvency disputes

MARCH 2023

This article by Trainee Solicitor Oliver Terry was published in ThoughtLeaders4 FIRE Starters magazine as part of its essay competition. Click here to read the publication (Oliver's article is on pages 30-33).

The growth of cryptocurrency generally and in Jersey

Crypto's role in the legal world is complex. The legal crypto industry is in constant evolution given the need to adapt to an ever-changing regulatory and legal landscape. Analysts estimate that the global cryptocurrency market will have tripled by 2030, hitting a valuation of nearly $5 billion.[1] With the number of new bitcoins issued per block halving every four years or so, the final bitcoin is not expected to be generated until 2140, and Bitcoin will exist even beyond this.[2] The opportunities that the crypto world offers and will continue to offer to the legal industry and FIRE practitioners through to 2033 and beyond should not be overlooked.

How does crypto relate to law?

Litigation in the cryptosphere is rapidly developing. In just three years, the English Court has confirmed that Bitcoin is capable of being property (*AA v Persons Unknown & Ors*[3]); that the legal jurisdiction of cryptocurrency is where the owner is based *(Ion Science Ltd v Persons Unknown & Ors*[4]); that cryptoassets are capable of being held on trust (*Wang v Darby*[5]); and that cryptoassets may not be used as security for costs (*Tulip Trading Ltd v Van Der Laan*[6]). Many cases heard in the English Court will be in relation to asset recovery and involve applications for freezing orders, disclosure orders, and orders to allow the recovery of cryptoassets. In such cases, it is absolutely essential to get the underlying basics right before initiating the action.[7]

Road to recovery

Because cryptoassets are by their very nature hidden, the key question becomes what legal remedies are available to recover cryptoassets that have been misappropriated by hacking or through fraud.

The victim must act quickly to locate and secure their crypto assets because of their temporary nature.[8] One way in which this issue might be addressed is by issuing urgent ex parte applications for injunctions (as exemplified in the case of *Fetch.Ai Limited v Persons Unknown & Ors*[9]) against the wrongdoers that may hold information relevant to the tracing of the misappropriated cryptoassets. Such applications should be made without notice and hearings should be held in private in order to make it more difficult for offenders or holders of the criminally tainted assets, to be tipped off.[10] Whilst the courts in Jersey have not had to contend

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publicly with freezing crypto assets to date, we can draw parallels with the position taken by the English Court in *Fetch.Ai Limited v Persons Unknown & Ors*.[11]

The identity crisis

A key feature of cryptocurrency is that it is anonymous. Originally, it was almost impossible to identify its owner, however this has now changed.

The law commission[12] defines crypto in its consultation paper as a 'data object' which is a 'thing' that can be considered a physical object *or property*. The paper's definition of this is welcome, as a data object follows rules which can support the legal process. Legally, crypto must be property otherwise an injunction cannot be secured. The 'thing' or crypto is held in a wallet (software programmes designed to hold public or private keys that allow owners to trade, monitor, track and hold their cryptocurrency[13]) that shows you how many 'things' you have. There are also crypto exchange businesses, custodian services/platforms where crypto can be bought/sold. These exchanges hold coins in the platform's wallet. Identifying this difference as to who holds the coins is key as this relationship dictates one's contractual rights in law. Custodians are crucial in the litigation recovery process as these exchanges hold the relevant information about a person. It is possible to obtain disclosure from such crypto exchanges – Binance is a popular one.

When 'things' go wrong

Common causes of action involving crypto are: breach of contract (Vorotyntseva v Money-4 Ltd[14] (Birss J)), fraudulent misrepresentation (Ion Science Ltd v Persons Unknown[15] (Butcher J)), breach of confidence (Fetch.ai v Persons Unknown[16] (Judge Pelling)) and insolvency applications (Ruscoe v Cryptopia Ltd[17] (Gendall J)). It is reported that crypto is becoming one of the most traditional forms of asset recovery with *Chainalysis* being the most reputable firm for this.[18] FIRE Insolvency Practitioners (**IP**) suggest that crypto is where insolvency work is headed. Additionally, London will see more crypto-related international arbitration.[19]

With the growth of digital assets comes a parallel growth in fraud. Around $8.6 billion in cryptoassets is estimated to have been laundered in 2021 alone and it is likely that financial crimes will accelerate in direct proportion to the use of cryptocurrency. As a result, cryptocurrency disputes are on the rise. There are various areas of disputes where crypto is involved, including fraud and asset recovery. The good news is that while crypto fraud is increasing, so too are the systems developed to trace these formerly untraceable assets.[20]

Service of proceedings is a pre-requisite to any legal action. Crypto cases makes this difficult, as how is an unknown person served? You must identify a person from the description of the crypto transaction (AA v Persons Unknown[21]). There are also conflicting views on which jurisdiction you serve the proceedings or application, whether the relevant jurisdiction is where a person/owner is domiciled or where a person/owner is resident. HMRC, in the case of Tulip[22] take it as residence. I don't believe it should be a person's residence because this isn't necessarily where the cryptocurrency is held. One's crypto wallet is on their mobile device so

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why can't situs be linked to the device? These are all issues IPs must take into account when thinking about bringing claims.

The impact of crypto within the legal industry IP world

Track and trace

Virtual currencies are not totally anonymous. You can seize bitcoin and trace transactions, if done correctly. People try to launder using crypto, but it is now possible to track and trace these transactions making it more difficult to hide money. Similarly, if an illegal product is bought, it is now possible to trace these transactions back to the purchaser/seller.

If an IP's investigations reveal a "voidable" transaction in cryptoassets, it may be necessary to seek a return of those assets.[23] *Chainalysis,* or its main competitor *CipherTrace,* are firms that specialise in tracing these types of crypto transactions.[24]

However, criminals are often one step ahead. They will use cutting edge technology to hide their fraudulently obtained gains. As a result, the victims of a fraud face a daunting challenge when they seek to recover assets. Unfortunately, it is extremely unlikely that asset tracing projects will recover all assets and the resources that need to be deployed may be disproportionate to the returns. However, artificial intelligence may be increasingly helpful in crypto tracing as it could make the process more efficient. International forensic investigator Burke Files, says: "It is all blockchain and very traceable when you have found the entry point".[25]

Insolvencies on the rise

It will come as no shock that we are heading towards another economic crisis. With the increased cost of living and rocketing inflation, businesses will struggle and there will be more insolvencies on the horizon. Crypto-related business is no different from the normal world. It will struggle too, and with the crypto market currently at one of its lowest points in years,[26] insolvencies are inevitable. Work to restructure these companies has grown and will continue to grow.

The growing use of cryptocurrency in Jersey and beyond

Jersey is quietly offering crypto investors incentives to move their money from more traditional international finance centres. The island is attracting crypto, blockchain and other fintech firms thanks to its favourable tax laws.[27] A number of Singapore managers are also using Jersey as the jurisdiction in which to domicile their crypto funds.

Given the increasing links to crypto in Jersey, it's highly likely that there will be crypto-related insolvency cases for Jersey lawyers. It is therefore important for lawyers in Jersey to understand crypto and its evolving ecosystem.[28]

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The importance of crypto know-how

There are many scams and frauds involving crypto and this activity is on the up. Criminals use crypto so that their criminal transactions are difficult or impossible to trace. It is therefore vital that insolvency and fraud practitioners understand what crypto is and the way it relates to their field, before advising clients on such matters.[29]

The current collapse of the crypto market is creating a string of insolvencies and posing new challenges for insolvency practitioners seeking to restructure crypto firms. The recent collapse of the crypto exchange FTX is an example of this. It is critical for insolvency practitioners to immediately investigate upon appointment whether a distressed company may hold any cryptoassets, and if so, take rapid steps to secure those assets. Securing cryptoassets can be a complex exercise. It may involve dealing with counterparties in multiple jurisdictions with enforcement difficulties similar to traditional asset tracing and recovery.[30]

The implications of getting it wrong (and some advice)

There are pitfalls aplenty when it comes to navigating the legal landscape of crypto. For example, when dealing with an application for a freezing order which carries with it a cross-undertaking in damages, it is important to freeze the correct crypto wallet. Failure to do so might block the ability to secure any monetary sum.[31]

Similarly, litigators may rush to apply for a worldwide freezing order on the basis of a risk of dissipation. However, in some cases this might be the wrong decision and sometimes a proprietary injunction would have been a better strategic move in terms of specifying particular property, obtaining disclosure orders and return of the cryptoassets.[32]

Even at the conclusion of a case, it is critical to retain focus. Settlement awards must be analysed. Consideration should be given to how the obtained crypto has been stored; either hot[33] or cold[34]. Storing on an exchange might not be secure enough for a client; in January 2022, *Crypto.com* admitted that hundreds of customers' accounts were compromised in a hack with losses of somewhere between $15 million and $33 million worth of Ethereum. It is also vital to seek expert advice on the sale of these assets if that is the planned course of action. The release of too many tokens in a volatile market could have catastrophic consequences, dramatically reducing or entirely destroying value for your client.[35]

[1] **"Thought Leaders 4: Crypto Insight 2022"** (2022) Crypto Insight 2022.

[2] Hayes, A. (2022) **What happens to Bitcoin after all 21 million are mined?**, Investopedia. Investopedia. Available at: https://www.investopedia.com/tech/what-happens-bitcoin-after-21-million-mined/#:~:text=With%20the%20number%20of%20new,6.25%20as%20of%20May%202020. (Accessed: November 7, 2022).

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[3] **AA v Persons Unknown & Ors** [2019] EWHC 3556 (Comm).

[4] **Ion Science Ltd v Persons Unknown & Ors** (Unreported) 2020.

[5] **Wang v Darby** [2021] EWHC 3054 (Comm).

[6] **Tulip Trading Ltd v Van Der Laan** [2022] EWHC 667 (Ch).

[7] "**Thought Leaders 4: Crypto Insight 2022**" (2022) Crypto Insight 2022.

[8] **Freezing crypto assets in the Cayman Islands (2022)** Collas Crill. Available at: https://www.collascrill.com/news-updates/articles/freezing-crypto-assets-in-the-cayman-islands-practical-considerations-1/ (Accessed: November 7, 2022).

[9] **Fetch.Ai Limited and Fetch.AI Foundation PTE Limited v Persons Unknown & Ors** [2021] EWHC 2254 (Comm)

[10] Freezing crypto assets in the Cayman Islands (2022) Collas Crill. Available at: https://www.collascrill.com/news-updates/articles/freezing-crypto-assets-in-the-cayman-islands-practical-considerations-1/ (Accessed: November 7, 2022).

[11] Ibid.

[12] UK (2022) **Digital Assets: Consultation Paper**. London: Law Commission. (Accessed: November 7, 2022).

[13] **Freezing crypto assets in the Cayman Islands (2022)** Collas Crill. Available at: https://www.collascrill.com/news-updates/articles/freezing-crypto-assets-in-the-cayman-islands-practical-considerations-1/ (Accessed: November 7, 2022).

[14] **Vorotyntseva v Money-4 Ltd** [2018] EWHC 2596 (Ch).

[15] **Ion Science Ltd v Persons Unknown & Ors** (Unreported) 2020.

[16] **Fetch.Ai Limited and Fetch.AI Foundation PTE Limited v Persons Unknown & Ors** [2021] EWHC 2254 (Comm).

[17] **Ruscoe v Cryptopia Ltd** [2020] NZHC 728.

[18] Thought Leaders 4: **TL4 FIRE Magazine Issue 10 - Contentious Insolvency** (2022) (Accessed: November 7, 2022).

[19] Ibid.

[20] **Thought Leaders 4: Crypto Insight 2022**" (2022) Crypto Insight 2022.

[21] **AA c Persons Unknown & Ors** [2019] EWHC 3556 (Comm).

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[22] **Tulip Trading Ltd v Bitcoin Association for BSV** [2022] EWHC 667 (Ch).

[23] Richie.turei@hsf.com (2022) **Crypto winter is here – what does it mean for insolvency practitioners?,** Herbert Smith Freehills | Global law firm. Available at: https://www.herbertsmithfreehills.com/insight/crypto-winter-is-here-%E2%80%93-what-does-it-mean-for-insolvency-practitioners (Accessed: November 7, 2022).

[24] Greggwirth (2021) **US law enforcers partner with cryptocurrency tracking firm to fight financial crime**, Thomson Reuters Institute. Available at: https://www.thomsonreuters.com/en-us/posts/investigation-fraud-and-risk/cryptocurrency-financial-crime/ (Accessed: November 7, 2022).

[25] **Thought Leaders 4: Crypto Insight 2022**" (2022) Crypto Insight 2022.

[26] **Top 50 cryptocurrency prices**, Coin Market Cap, price charts and historical data / crypto.com. Available at: https://crypto.com/price (Accessed: November 7, 2022).

[27] Glover, G. **The UK's offshore tax havens are quietly luring investors away from the likes of the Cayman Islands and Bermuda this 'crypto winter'**, Business Insider. Business Insider. Available at: https://markets.businessinsider.com/news/currencies/crypto-bitcoin-tax-havens-jersey-guernsey-investing-analysis-regulation-law-2022-8 (Accessed: November 7, 2022).

[28] Kient (2022) **Jersey an attractive option for Asia's Crypto Fund Managers**, Law.asia. Available at: https://law.asia/jersey-singapore-tax/ (Accessed: November 7, 2022).

[29] Trozze, A. et al. (2022) **Cryptocurrencies and future financial crime - crime science**, BioMed Central. Springer Berlin Heidelberg. Available at: https://crimesciencejournal.biomedcentral.com/articles/10.1186/s40163-021-00163-8 (Accessed: November 7, 2022).

[30] Richie.turei@hsf.com (2022) **Crypto winter is here – what does it mean for insolvency practitioners?**, Herbert Smith Freehills | Global law firm. Available at: https://www.herbertsmithfreehills.com/insight/crypto-winter-is-here-%E2%80%93-what-does-it-mean-for-insolvency-practitioners (Accessed: November 7, 2022).

[31] **Thought Leaders 4: Crypto Insight 2022**" (2022) Crypto Insight 2022.

[32] Ibid.

[33] A hot wallet is connected to the internet and could be vulnerable to online attacks, which could lead to stolen funds, but it's faster and makes it easier to trade or spend crypto.

[34] Cold storage is offline which can protect your digital assets. Since these digital wallets aren't connected to the internet, they're less susceptible to hacks.

[35] **Thought Leaders 4: Crypto Insight 2022**" (2022) Crypto Insight 2022.

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